

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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| In the Matter of the Petition | : | |
| of | : | |
| JEFFREY PARK, LTD. | : | DETERMINATION |
| | : | DTA NO. 812183 |
| for Revision of a Determination or for Refund | : | |
| of Mortgage Recording Tax under Article 11 of | : | |
| the Tax Law with Reference to an Instrument | : | |
| Recorded on October 22, 1992. | : | |

Petitioner, Jeffrey Park, Ltd., 60 Morrow Avenue, Scarsdale, New York 10583, filed a petition for revision of a determination or for refund of mortgage recording tax under Article 11 of the Tax Law with reference to an instrument recorded on October 22, 1992.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on May 12, 1994 at 1:15 P.M., with all briefs to be submitted by June 30, 1994. The Division of Taxation's brief was received on May 23, 1994. Petitioner's brief, in response, was submitted on June 27, 1994. Petitioner appeared by Seymour Robinowitz, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

ISSUE

Whether a mortgage given by petitioner upon refinancing secured the same principal indebtedness as an earlier consolidated primary mortgage so that it was exempt from the mortgage recording tax as a supplemental mortgage.

FINDINGS OF FACT

Petitioner, Jeffrey Park, Ltd., is a limited partnership which owns a housing complex known as Jeffrey Park on Morrow Avenue in Yonkers, New York, described by Alan Zaretsky, petitioner's sole general partner, as follows:

"The mortgaged property is approximately 464 residential units in two buildings, two wings per building. It's an elevator building. It encompasses approximately six acres of land with a pool. There are several offices on the

complex, as well as my own real estate office" (tr., p. 29).

Petitioner by Alan Zaretzky, its general partner, executed a mortgage (more exactly, a "Multifamily Mortgage, Assignment of Rents and Security Agreement") dated January 6, 1988 to Bayside Federal Savings and Loan Association ("Bayside Federal") in the principal sum of \$4,388,436.81. A rider to this mortgage detailed petitioner's total indebtedness to Bayside Federal as follows:

"34. The indebtedness herein is evidenced by a Consolidated Note, together with a Demand Note¹ for \$4,388,436.81 (for a single total indebtedness of \$10,000,000.00), and is secured by this Mortgage and an Agreement of Consolidation, Modification, Extension and/or Spreading of Mortgages dated the date hereof, and reference is made thereto for rights as to acceleration of the indebtedness evidenced by such Notes. The Consolidated Note shall be the governing Note.

"35. This Mortgage, together with an Agreement of Consolidation, Modification, Extension and/or Spreading of Mortgages, are hereby made to secure a first mortgage lien on the premises in the amount of \$10,000,000.00. However, pursuant to the terms contained in the Consolidated Note executed this date, negative amortization may increase the principal resulting in an additional lien of \$1,500,000.00 for a total lien on the premises of \$11,500,000.00" (emphasis added).

The "Westchester County Recording and Endorsement Page", which was part of the mortgage described in Finding of Fact "2", shows a mortgage amount of \$5,888,436.81 and total mortgage recording tax received of

\$58,884.00. Mortgage recording tax was paid on not just the principal sum of the mortgage dated January 6, 1988 of \$4,388,436.81 but also on an additional \$1,500,000.00, representing an additional lien which might result from negative amortization. The principal sum of \$4,388,436.81 plus \$1,500,000.00 equals \$5,888,436.81, the mortgage amount shown for purposes of calculating tax. (Given the description of the mortgaged property in Finding of Fact "1" as having 464 residential units, it was unexplained why the endorsement page shows a check-off of the box indicating "1-6 units" instead of the box for "over 6 units".)

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Neither such consolidated note nor the demand note were introduced into evidence.

Negative Amortization

Mr. Zaretsky, who was a very articulate witness, testified that in early 1988, at the time of petitioner's financing with Bayside Federal, negative amortization "was a new concept" (tr., p. 31). He elaborated as follows on this new financing tool which allowed for a fixed monthly payment despite fluctuating interest rates:

Mr. Zaretsky: "As you are aware, interest rates at that time were fluctuating tremendously."

* * *

Administrative Law Judge: "And your interest rate . . . was an adjustable rate?"

Mr. Zaretsky: "Was adjustable, that's correct, with a constant payment. So there was the interest rate which determined what you paid in interest and then there was an amortization based on a schedule. As the interest rate changed, if it went up, the amortization shrunk; as the interest went down, the amortization would conversely increase. As we know, interest rates went up, the amortization did indeed shrink, and it shrunk to the point where the interest [due] exceeded the constant payment that was being made on behalf of this mortgage.

* * *

"That resulted in a negative amortization or additional money being put on the principal of the loan, okay, which then increased the interest again, because you're paying on a higher principal amount. And the mortgage allowed for this to a maximum of 15 percent of the base ten million, or an additional 1.5 million dollars, at which time if it ever reached that, then the new [higher] payment would have to be paid" (tr., pp. 31-32).

Petitioner's loan from Bayside Federal was made shortly after the Wall Street crash of October 13, 1987. Mr. Zaretsky explained:

"You have to remember that a mortgage of this size -- this is not a small loan, and there are not that many banks or institutions capable of making this particular size loan. And at the time, the market was very volatile and borrowers were subject to what was available There were only certain banks that were loaning and there were only certain formats that were available" (tr., pp. 33-34).

Approximately 4½ years later, in October 1992, Mr. Zaretsky was able to obtain refinancing in the form of a loan of \$11,400,000.00 from ARCS Mortgage, Inc. ("ARCS Mortgage") of Calabasas, California (a subsidiary of the Bank of New York) at an interest rate of 8¾%, and which also "allowed for a true fixed payment" (tr., p. 33). \$10,363,170.45 of the principal sum of \$11,400,000.00 was used to pay off petitioner's outstanding indebtedness to

Bayside Federal. This \$10,363,170.45 owed to Bayside Federal included the initial principal sum of \$10,000,000.00 plus an increase in such principal of \$363,170.45, representing negative amortization. The remaining \$1,036,829.55 of the principal sum borrowed from ARCS Mortgage of \$11,400,000.00 was apparently newly advanced money covered by a "Multifamily Mortgage" (Division's Ex. "J") dated October 22, 1992 between petitioner and ARCS Mortgage.

A "Consolidation, Extension and Modification Agreement" dated October 22, 1992 (Petitioner's Ex. "K") between petitioner and ARCS Mortgage noted that petitioner was indebted to ARCS Mortgage in the principal sum of \$11,400,000.00 and that petitioner "assumes all of the obligations and agreements of the notes . . . and mortgages . . . listed on Exhibit B hereto." This Exhibit B provided a detailed history of seven mortgages obtained by petitioner (and related predecessor entities) which over time evolved into petitioner's principal indebtedness of \$11,400,000.00 to ARCS Mortgage:

| <u>Borrower</u> | <u>Lender</u> | <u>Date of Mortgage</u> | <u>Principal Amount</u> |
|-------------------------|--|-------------------------|-------------------------|
| 1. Jeffrey Towers, Inc. | First National City Bank | August 1, 1967 | \$3,000,000.00 |
| 2. Jeffrey Towers, Inc. | Long Island Savings Bank | December 19, 1967 | 200,000.00 |
| 3. Jeffrey Towers, Inc. | First National City Bank | August 5, 1968 | 3,250,000.00 |
| 4. I.Z. Equities, Inc. | The Brooklyn Savings Bank | January 12, 1973 | 250,000.00 |
| 5. Jeffrey Park II | Independence Savings Bank | August 17, 1983 | 45,051.21 |
| 6. Jeffrey Park, Ltd. | Bayside Federal Savings and Loan Association | January 6, 1988 | 4,388,436.81 |
| 7. Jeffrey Park, Ltd. | ARCS Mortgage | October 22, 1992 | 1,036,829.55 |

This Exhibit B to the "Consolidation, Extension and Modification Agreement" dated October 22, 1992 noted that the first six mortgages were consolidated by an earlier "Consolidation, Modification and Extension Agreement" dated January 6, 1988 by and between petitioner and Bayside Federal to form a single lien of \$10,000,000.00. These six mortgages as consolidated were then assigned by an "Assignment of Mortgage" dated October 22, 1992 (Division's Exhibit "I") from Bayside Federal to ARCS Mortgage in consideration of \$10,363,170.45. These assigned mortgages in the principal amount of \$10,363,170.54, together with the principal amount of \$1,036,829.55 of the seventh mortgage listed above, total \$11,400,000.00, petitioner's principal indebtedness to ARCS Mortgage.

On October 23, 1992, petitioner recorded the Multifamily Mortgage dated October 22, 1992 and paid mortgage recording tax of \$10,368.00 based upon a mortgage amount of \$1,036,829.55. Subsequently, petitioner filed a Form MT-15.1, Mortgage Recording Tax Claim for Refund, dated December 11, 1992 seeking a refund of the \$10,368.00 paid a couple of months earlier. Petitioner provided the following explanation for its refund claim:

"It is claimant's contention that the mortgage assigned by [Bayside Federal] included the mortgage tax paid on the total principal amount of \$11,500,000 and therefore the mortgage tax having been fully paid, the payment made on October 23, 1992 for the consolidated mortgage included a duplication and overpayment of the mortgage tax in the amount of \$10,368 [I]t is submitted that the payment of \$10,368 required for the recording of the mortgage held by [ARCS Mortgage] and consolidated to constitute a single lien of \$11,500,000 was an erroneous overpayment of the mortgage tax since the mortgage tax had been previously fully paid on the mortgage lien of \$11,500,000 recorded on Jan. 15, 1988.

" . . . [T]he recording of the mortgage with [ARCS Mortgage] should be exempt from the payment of a duplicate recording tax which had been previously paid.

"Since the mortgage lien assigned to [ARCS Mortgage] in the transaction on October 22, 1992 was in the amount of \$11,500,000,² the consolidated mortgage represented the same principal amount"

The Division, by a letter dated May 26, 1993 of Marjorie A. Kugler, Tax Technician, denied petitioner's refund claim dated December 11, 1992. Ms. Kugler explained that by reason of the execution and recording of the new mortgage dated October 22, 1992 between petitioner and ARCS Mortgage in the principal sum of \$1,036,829.55, mortgage recording tax was payable:

"This is not a supplemental mortgage which is exempt Mortgage tax was payable because a new mortgage had been given.

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A close review of Division's Exhibit "I", "Assignment of Mortgage", dated October 22, 1992, shows the assignment of six mortgages by Bayside Federal to ARCS Mortgage in consideration of \$10,363,170.45. These six mortgages correlate with the six mortgages numbered one through six in Finding of Fact "6". The mortgage in the amount of \$4,388,436.81, made by petitioner to Bayside Federal, was one of the six assigned. As noted in Finding of Fact "3", mortgage recording tax was paid on such \$4,388,436.81 and on \$1,500,000.00, an additional lien which might result from negative amortization upon the recording of the \$4,388,436.81 mortgage.

"The taxpayer asks us to look to the substance rather than the form of the transaction. They state that this mortgage was a duplication. The choice of form did not rest with the tax authorities but with the taxpayer. If he unfortunately chose a form which was taxable instead of an equally available form which was non-taxable, he must bear the consequences."

SUMMARY OF THE PARTIES' POSITIONS

The Division argues that the mortgage recording tax is a tax on the privilege of recording a mortgage and not on the privilege of lending money. Therefore, tax of \$10,368.00 was properly paid on the new mortgage dated October 22, 1992 between petitioner and ARCS Mortgage in the principal sum of \$1,036,829.55. The Division contends that this mortgage was not a supplemental mortgage to the 1988 consolidated mortgage assigned by petitioner to ARCS Mortgage. "Rather, the 1992 mortgage . . . secured a new indebtedness which was not the indebtedness secured by the 1988 consolidated mortgage" (Division's brief, pp. 4-5). Because the transaction at issue was within the form which the statute has made taxable, the Division maintains it is subject to tax.

Petitioner contends that the tax of \$10,368.00, which it paid on the recording of the mortgage dated October 22, 1992 between it and ARCS Mortgage in the principal sum of \$1,036,829.55, was a duplicative payment because it duplicated its earlier payment of tax on the additional lien of \$1,500,000.00, which might result from negative amortization, that was part of its mortgage with Bayside Federal dated January 6, 1988. Although the principal sum of the January 6, 1988 mortgage was \$4,388,436.81, a rider to the mortgage included a provision for potential negative amortization of \$1,500,000.00 and when the mortgage of January 6, 1988 was recorded, tax was paid on a mortgage amount of \$5,888,436.81. Petitioner maintains that "the funding on October 22, 1992 by ARCS did not represent any new or further indebtedness or obligation other than the original principal indebtedness secured by the mortgage dated January 6, 1988" (petitioner's brief, p. 4). Rather, according to petitioner, "[t]he additional principal received by the Petitioner in the amount of \$1,036,829.55 from [ARCS Mortgage] . . . represented the balance of the mortgage funds already secured by the mortgage lien for which the mortgage recording tax had been paid on January 6, 1988", and "the recitation in the

Assignment (Exhibit 'T') that the amount actually paid to the petitioner was \$10,363,170.45 and not \$11,500,000.00, does not alter the fact that the mortgage assigned to ARCS was a mortgage lien in the amount of \$11,500,000.00 and not \$10,363,170.45" (petitioner's brief, pp. 6-8). In sum, petitioner maintains that "[t]he mortgage made by Petitioner with ARCS is a supplemental mortgage within the terms of the statute" (petitioner's brief, p. 10).

CONCLUSIONS OF LAW

A. Tax Law § 253(1) imposes a mortgage recording tax:

"for each one hundred dollars and each remaining major fraction thereof of principal debt or obligation which is, or under any contingency may be [,] secured at the date of the execution thereof or at any time thereafter by a mortgage on real property"

The mortgage recording tax is not a tax on property but rather is imposed upon the privilege of recording a mortgage; the underlying debt is the basis for computation (Matter of S. S. Silberblatt, Inc. v. State Tax Commn., 5 NY2d 635, 186 NYS2d 646, cert denied 361 US 912, 4 L Ed 2d 183).

B. Tax Law § 250 defines "mortgage" as "every mortgage or deed of trust which imposes a lien on or affects the title to real property"

C. Petitioner cannot sidestep the fact that, as noted in Finding of Fact "6", on October 22, 1992 it executed a mortgage on real property to ARCS Mortgage in the amount of \$1,036,829.55. To avoid the imposition of mortgage recording tax under Tax Law § 253(1), petitioner must show that this mortgage to ARCS Mortgage in the amount of \$1,036,829.55 is a "supplemental mortgage" not subject to mortgage recording tax under Tax Law § 255(1) which provides as follows:

"(a) If subsequent to the recording of a mortgage on which all taxes . . . have been paid, a supplemental instrument or mortgage is recorded [1] for the purpose of correcting or perfecting any recorded mortgage, or [2] pursuant to some provision or covenant therein, or [3] an additional mortgage is recorded imposing the lien thereof upon property not originally covered by or not described in such recorded primary mortgage for the purpose of securing the principal indebtedness which is or under any contingency may be secured by such recorded primary mortgage, such additional instrument or mortgage shall not be subject to taxation under this article . . . unless it creates or secures a new or further indebtedness or obligation other than the principal indebtedness or obligation secured by or which under any contingency may be secured by the recorded primary mortgage"

It is observed that the first criteria for exemption numbered above has been liberally interpreted by the Court of Appeals to include an exemption from mortgage recording tax for a so-called "extension agreement" which released the original obligor while adding new obligors who assumed the mortgage debt (Suffolk County Federal Savings & Loan Assn. v. Bragalalini, 5 NY2d 579, 186 NYS2d 602). Similarly, the determination of the former State Tax Commission was also annulled in Brodsky v. Murphy (26 AD2d 225, 272 NYS2d 238, 240) because:

"The absence of a cancellation of the original mortgage or a showing of an additional or new indebtedness precludes a finding that in fact there was a new mortgage loan"

D. Consequently, in the matter at hand, it must be determined whether the mortgage on real property to ARCS Mortgage in the amount of \$1,036,829.55 dated October 22, 1992 constituted additional or new indebtedness to support a finding that there was a new mortgage loan.

E. Petitioner argues that the mortgage dated October 22, 1992 to ARCS Mortgage did not constitute additional or new indebtedness because the provision permitting negative amortization up to \$1,500,000.00 in the mortgage dated January 6, 1988 to Bayside Federal represented the same indebtedness. However, this contention fudges the nature of negative amortization which was well described by Mr. Zaretsky, as noted in Finding of Fact "4". The potential for negative amortization is not the same as an existing indebtedness. Admittedly, petitioner was required to calculate mortgage recording tax due of \$58,884.00 based upon the principal sum of the mortgage dated January 6, 1988 of \$4,388,436.81 plus an additional \$1,500,000.00, representing an additional lien which might result from negative amortization because Tax Law § 253(1), cited in Conclusion of Law "A", imposes mortgage recording tax on "principal debt or obligation" which "under any contingency may be [,] secured at the date of the execution thereof or at any time thereafter by a mortgage on real property" (emphasis added). Nonetheless, negative amortization which might lead to an additional lien is not the same as an existing indebtedness.

F. Petitioner faces the unavoidable fact that it executed a new mortgage of \$1,036,829.55 to ARCS Mortgage. In Sverdlow v. Bates (283 App Div 487, 129 NYS2d 88), the court rejected the taxpayer's argument that "since the same result could have been obtained without the payment of a tax by use of an instrument of a different form, it is inequitable to require a payment of the tax" (id., 129 NYS2d at 91). The court observed:

"If a transaction comes within the form which the statute has made taxable, it is no answer to say that it is indistinguishable in substance from a transaction in a different form which could have accomplished the same result in a non-taxable manner" (id.).

In the matter at hand, it does appear that in early 1988, when petitioner obtained financing from Bayside Federal, it did not have the option to borrow \$11,400,000.00 (the amount that ultimately ARCS Mortgage financed) from Bayside Federal and that it was limited to the terms it obtained: \$10,000,000.00 plus up to an additional \$1,500,000.00 if negative amortization resulted from its fixed monthly payment. Therefore, it may well be that, unlike the taxpayer in Sverdlow v. Bates (supra), petitioner did not have the ability to choose a different form for its transaction with ARCS Mortgage so as to avoid additional mortgage recording tax. Nonetheless, the transaction at issue was within the form which the statute has made taxable since the mortgage to ARCS Mortgage in the amount of \$1,036,829.55 dated October 22, 1992 was a new indebtedness.

G. Furthermore, since the Division did not improperly deny petitioner an exemption under Tax Law § 255, no inappropriate double taxation occurred (see, Matter of Weiss, Tax Appeals Tribunal, October 13, 1994).

H. The petition of Jeffrey Park, Ltd. is denied, and the denial of petitioner's refund claim is sustained.

DATED: Troy, New York
December 22, 1994

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE